Debt is a Four-Letter Word

Your pocket guide to living a debt-free life

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Download my first book, Live Simple Get Rich for FREE here: http://www.archive.org/download/LiveSimpleGetRich/LiveSimpleGetRich.pdf

INTRODUCTION

Debt is ubiquitous. We, as consumers, have credit card debt, car loans, student loans, mortgages, home equity lines of credit, and unsecured loans. All across the world, everyday people are carrying an enormous amount of debt. This is on top of the unfathomable debt carried by corporations and especially governments.

The recent housing bubble helped fuel an unprecedented run-up in household debt. Fueled by artificially low interest rates, consumers snapped up homes like there was no tomorrow. It got so bad that it didn't matter if the borrower could even afford the loan. Anyone with a pulse could get a mortgage and thus the housing boom began. As long as housing prices continued to rise, everyone was happy.

People could borrow against the equity in their homes to buy anything they wanted. Normally, people would borrow against equity to make improvements on the house, thus raising its value. Not this time. People took out equity to buy cars, vacations, furniture, big-screen TVs and any other consumer item they could think of. The consumer went on a massive spending spree and retailers were jumping for joy.

Credit card companies were handing out credit cards like candy to anyone who wanted one. Homeowners would

run up massive credit card debt, and then take out a home-equity loan to pay off the credit card debt. This may be a wise thing to do since the home-equity loan is tax-deductible. The problem was the idiot homeowner went right back out and maxed-out their credit cards.

This cycle was repeated until one day the housing bubble popped. Gone were the days of easy credit and easy financing. It was time to pay the piper. Those people with adjustable-rate mortgages found out that their rates were readjusting higher. This meant a much higher mortgage payment. Many couldn't afford it and immediately went into foreclosure.

Bankruptcies and foreclosures have soared over the past several years. Incomes have remained stagnant and actually have declined in real terms over the past thirty years. People have been using debt as a substitute for income. Now they can no longer pay off the debt with their income.

This little book is for those on the brink of disaster. It's also for those who are doing okay now but can see the falls on the horizon. The methods I describe in this book will get you out of debt permanently. You must have patience and discipline and most importantly, you must not incur more debt while on this program! If you do incur more debt, you'll never become debt-free and the methods in this book will be worthless.

I won't discuss how this debt crisis came into being or bore you with a lot of historical facts. You're in debt trouble and you need to get out. First, I'll discuss how to change your mindset from using debt to using cash. Second, you'll learn the five-step process for eliminating your debt once and for all. Third, you'll learn how to live a debt-free life.

From there on, you'll learn about living a life without credit cards and loans. Can you buy a large ticket item without going into debt? Can you buy a car without financing it? The answer to both of these is a resounding yes.

I'll touch on credit reports briefly. Many people have made a big deal out of credit reports as if you're life depended on them. It is important to go through your credit reports and remove incorrect information. However, once you're debt free and living a cash-based life, you'll quickly forget about your credit report. It simply won't be important to you anymore.

Depending on the size of your debt, your journey to debt freedom may take several years or even longer. I did say you'll need patience and discipline. There are no quick fixes aside from a cash windfall large enough to pay off all your debts. That said, let's get going!

A CASH MINDSET

Nearly everything today is paid for with credit cards. Whether you are at the grocery store, gas station, department store, or a fast-food restaurant, chances are good you're paying with a credit card or an ATM card. Cash is not as popular as it once was. For many, it is far too convenient to pay with plastic than paper. Yet, not to long ago, cash was considered king. Credit cards were used for larger purchases or for emergencies. A cash mindset has been replaced with a credit mindset.

It's time to go back to the cash mindset. You've started your journey to live debt free so you must change the way you look at money and spending. In the past, it was so easy to buy something with the credit card. You knew you couldn't afford it outright so you put in on the card. The monthly payments are low and you can easily afford adding more to the balance. Pretty soon, you're maxed out on the card and your minimum monthly payment has now ballooned into something that will make a serious dent in your cash flow. You can't stop spending so you buy things using another credit card, then another, then another. The balances start piling up and you continually max out your cards. Soon, you're falling behind on your payments and the creditors start calling. You're spiraling out of control and on your way to insolvency. This is the worst-case scenario for those who have a credit mindset.

Yet it afflicts millions of people every year as bankruptcies have soared. You need to change your mindset from credit-based to cash-based. If you are serious about living debt free, this is the first thing you must do.

From now on, everything you buy will be paid for either with cold, hard cash or your bank ATM card. Buying on credit is no longer an option. How much you spend is determined by how much cash you have on hand. You'll think twice about buying a new pair of shoes or a new DVD. If you don't have the cash on hand, you won't buy it. You can use your ATM card, but knowing that the money will be gone after you bought something, you'll think twice about buying something you really don't need.

You'll start planning your expenditures more carefully. You'll shop with a list and reduce the impulse purchases. You'll save up for larger purchases. Instead of instant gratification, you'll learn to appreciate delayed gratification. This thinking goes against our entire "gotta have it know" culture. But it is the healthiest course to take, financially speaking. You won't have to worry about keeping up with the Joneses by buying the latest and greatest gadgets. You'll learn to keep what you have and make it last. Let everyone else struggle to pay their mounting credit card bills. You'll be debt free, have everything you need and plenty of money in the bank.

THE 5-STEP DEBT-FREE PLAN

Okay, here are the meat and potatoes of this little book. These five steps will show you how to get out of debt and stay out. This isn't a quick fix that eliminates your debt all at once. You will be paying off your debt each month until it's gone. Depending on the size of your debt (not including your mortgage), it can take anywhere from 2-4 years, if not longer. You must have patience and discipline for you to succeed.

This plan was originally derived from Dave Ramsey, author of the Total Money Makeover. I've modified it slightly and made it a little simpler. It is the best debt reduction plan I've seen and it has worked wonders for me personally. All you need is your computer, or a pen and paper. This 5-step process originally appeared in my first book, Live Simple Get Rich.

Step 1: STOP USING YOUR CREDIT CARDS! This is the obvious first step. You must stop using your credit cards. Take all of them out of your wallet and cut them up. That includes American Express, gas cards, department store cards, home improvement stores, and boutique store cards. Anything that resembles a credit card gets cut up. You can keep your ATM card. If this sounds a bit harsh, well, it is. The only way out of debt is to go cold turkey. You can't ease your way out of credit cards. If you can't

summon the will to cut up your credit cards, then you don't have the discipline to get out of debt.

Step 2: Gather your latest statements. This should include all of your credit cards, lines of credit, loans, your car payment, and your mortgage. On your computer or a piece of paper, write down the name of each card, the minimum monthly payment and the balance. Order the list from the smallest balance to the largest. Total the balances. See below for an example.

Card	**Min Payment**	**Balance**
Department Store	12	245
VISA	20	356
Gas Card	25	529
Mastercard	50	1500
Furniture Store	75	3520
Mastercard	90	4700
Discover	100	6000
Car	400	20000
House	2500	350000
TOTAL		**386850**

Step 3: You're going to pay off the smallest balance first and work your way up to the larger balances. Other financial experts would have you pay off your largest balance first, or the account with the highest interest rate. There is some logic to paying off the largest balance first. However, what is missing is the positive psychological effect of achieving a goal; the goal being pay of a debt. By

starting with the smallest balance first; you'll achieve the psychological satisfaction of paying off the debt faster than waiting years to pay off the largest debt. Focus on paying off the smallest debt first. Pay the minimum monthly payments for all other accounts. Since you are no longer taking on new debt (you did cut up your credit cards, didn't you?) your balances will go down slowly but surely. If you pay more than the minimum for the smallest debt, please do so. The faster you can pay off the first debt, the easier it will be to pay off the rest as we'll soon see.

Step 4: After you've paid off the first account, congratulate yourself! Now comes the fun part. It's what Dave Ramsey calls the "Snowball Effect." You're going to take the payment you were making on the first account and apply it to the second account on top of what you are currently paying. As an example, take a look at the table from Step 2. You've just finished paying the department store debt of $245. You've been making the minimum payments of $12. Now, you're going to take that $12 and add it to the VISA account payment of $20 for a total payment of $32. The VISA account will now be paid off almost twice as fast because of the additional payment. The snowball effect really kicks in after you've paid off a few accounts. For example if you've paid off the first four accounts on the table, your monthly payment for the fifth account would be $107.

Step 5: The final step is to repeat until your debts are paid in full. Normally, all of your credit card and any unsecured loans and lines of credit will be paid off first leaving your car loan and mortgage.

Once your credit cards and loans are paid off, you can apply the last monthly payment--which should be quite large--to your car loan. You can pay off your car loan in less than half the time. Just think no more car payments! Trust me, that is one of the nicest feelings to have.

You can generally apply additional snowball payments to your mortgage unless there is a pre-payment penalty. If you do have pre-payment penalty clause, then I would only pay the standard mortgage payment. You can take the monthly payment you were making on your debts and put it in the bank. If you do not have a pre-payment penalty, then I would advise paying off your mortgage as quickly as possible. You'll save hundreds of thousands of dollars in interest and you'll be on of the few people to actually own their homes. Many people never think they'll actually pay off their mortgage. They never stay in their homes long enough to pay it off as they are constantly moving to new homes and taking on additional mortgage debt. It's self-perpetuating. Pay off your mortgage, own your home free and clear.

DEALING WITH CREDITORS

If your debt levels are high, but manageable and you haven't missed any payments, you can safely skip this chapter. You can apply the 5-step debt-free process immediately. For those that are behind on their payments and fielding calls from creditors and collection agencies, here are some tips for getting them off your back.

Under the Federal Fair Debt Collection Practices Act, outside collection agencies cannot call you at unreasonable hours, generally before 8am and after 9pm. Nor can they verbally abuse you, call you at work, add unauthorized charges to your account, and make any misleading claims against you. You can request in writing that the collection agency stop all communications with you, with a few exceptions.[1]

If you're debts haven't gone to a collection agency yet, it's best to contact your creditors directly and negotiate a payment schedule that fits your budget. Creditors do not want to write off any debt and will work with you to ensure the account is paid off. Be upfront about your situation and your determination to make your payments.

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[1] (Nolo)

You may be able to negotiate a lower payment and, perhaps a lower interest rate. Your creditors may stop any additional late fees and over-the-limit fees.

Once you've negotiated a payment schedule, stick to it and don't miss a payment. Follow the 5-step plan, reduce your spending, and make the sacrifice. Don't miss a payment or you will risk having the account placed with a collection agency.

Negotiating with a collection agency requires a bit more tenacity since they will almost always demand payment immediately through an ATM deposit, wire transfer, and payment with another credit card. Don't do any of these as they can add additional and costly fees to your account. Be firm and polite and insist you will mail them a check. Don't let them bully you into paying anymore than is stated. You're not required to pay more. Ensure them that you want to pay off the account. Negotiate with the collection agency just like you would negotiate with a creditor. By showing a genuine effort to pay, a mutually agreed payment schedule can be reached and the annoying phone calls can be reduced and/or eliminated.

CREDIT COUNSELING SERVICES

Now, if you're like me, I hate negotiating with people. The last thing I want to do is haggle with a creditor over a payment schedule and interest rate. Some people simply don't have the tenacity or the patience to directly negotiate with people. In that case, it may be best to use a Consumer Credit Counseling agency.

These agencies are typically non-profit organizations that offer a variety of services including:

- Budget counseling and education
- Debt management plans
- Counseling referral services
- Financial literacy courses
- Housing counseling[2]

The primary service is debt management. These agencies will negotiate with your creditors and, in many cases, lower your monthly payment and reduce your interest rate. They can generally stop all late payment and over-limit fees. Creditors will generally accept the payment schedules offered by the counseling agencies since any

[2] (NFCC)

failure on your part to pay will result in a resumption of penalties, fees, and higher payments.

To get started in these programs, you'll generally send them all the latest creditor statements. They'll contact the creditors and work out a payment schedule. You'll send one cumulative monthly payment to the counselor and they will disperse the monies to each creditor, minus a small monthly fee payable to the agency. Depending on the agency, you'll need to fax or mail your creditor statements every 3-4 months. Many of them have comprehensive online tools so you can manage your account online. You can update your creditor balances, interest rate, monthly payments and due dates. It's important to keep the statements balances updated.

The counseling agency will deal with nearly any issue you have with a creditor or collection agency. The nice thing about signing up with a credit counseling agency is that the harassing phone calls and collection letters will stop. If they don't you just call your assigned counselor and he/she will deal with it.

After a month or two on the program, the letters and phone calls will stop and you'll just send in your monthly payment. You should use the 5-step debt reduction process described above even when using a counseling agency. Once you've paid off one account on the program, you can instruct your counselor how to disperse payment

from the newly closed account. In this case, you would have the payment from the closed account applied directly to the second smallest balance.

Credit Counseling Services can be a great way to pay off your debts if you don't want to deal directly with creditors and collection agencies. You will pay a fee for the convenience. However, these services are not necessary to become debt free if you have the tenacity and patience to deal with unpleasant people and circumstances.

If you want more information about selecting a counseling agency, contact the National Foundation for Credit Counseling at http://www.nfcc.org or call 1-800-388-2227.

BANKRUPTCY

I'm going to touch briefly on the subject of bankruptcy. If you're serious about becoming debt-free, you won't want to think about bankruptcy. However, there are times where it may be the only choice, whether it's a job loss and prolonged unemployment, a medical emergency, a family emergency, or any other unforeseen situation where income is severely curtailed or cutoff altogether.

Bankruptcy is not to be used as a way to get out of your legal obligations to repay your debt. Recent changes in bankruptcy law have made it much harder to file a Chapter 7 bankruptcy if you have means of repaying. The courts will force you in to a Chapter 13 bankruptcy where you pay off your creditors in monthly payments.

According to a recent report from the U.S. Bankruptcy Courts, there were over 800,000 bankruptcy filings for fiscal year 2007.[3] A lot of people have simply taken on too much debt thanks to ridiculously low interest rates from and creditors willing to lend to anyone with a pulse. The low interest rates make it easier to take on more debt while maintaining the same income. You only hope that

[3] (Redmond, 2007)

something drastic doesn’t happen to you. For too many people, they’re one paycheck away from insolvency.

The best way to avoid bankruptcy is to live within your means and not take on debt, beyond your car and mortgage. Then, if a hardship comes your way, you won’t have to file bankruptcy.

YOUR CREDIT REPORT

You've probably seen the television and radio ads urging you to check your credit report. It's always prefaced with the ability to obtain credit at favorable rates. It's become a bit of a cottage industry over the last decade. They say to know what's in your credit report so you can take on more debt. While it's true that having a clean credit report can increase your chance of obtaining credit at lower rates, if you don't have any debt and don't take on any more debt, why should you care about your credit report?

Unfortunately, many employers check credit reports on potential hires and use that as a partial basis for hiring. Personally, I think the practice is unwarranted. You're hiring a person to do a job, not grant credit. Proponents of the practice would argue that looking at credit reports tell a lot about the person's psychological makeup and his/her ability to handle the job. Did they have a bankruptcy? Late payments? Missed payments? Do they have too much debt or too little? How high are the balances? All of these relay negative things to a potential employer. Regardless, I think it's an unnecessary intrusion. Even if a company provides a credit card for travel and expenses, having a negative credit report shouldn't be a factor in the hiring process. If you're credit is less than stellar, you won't receive a company-issued credit card. You'll have to pay for everything yourself and then expense it. This is what I

do whenever I travel on business, which fortunately, is rarely more than once a year.

That being said, it is a good idea to check your credit reports from the three credit bureaus just to verify that all the data is correct and remove any incorrect or fraudulent data.

You can obtain a free copy of your credit report once a year from the three major credit agencies, Experian[4], TransUnion[5], and Equifax[6].

You can do all of this online at one web site setup by the above credit agencies. Just visit http://www.annualcreditreport.com. Select the state where you reside and enter all the required information. The site also provides helpful information for placing fraud alerts on your credit report in case you've been the victim of, or suspect identity theft.

Once you receive your credit report, check through it thoroughly. Verify that all the accounts listed, both past

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[4] http://www.experian.com

[5] http://www.transunion.com

[6] http://www.equifax.com

and present, are indeed yours. Make sure the account numbers, balances, payments, and the name the account was opened with is correct. If you have a common name, it's possible that accounts from other people with similar names could appear in your report.

If there is any information that is incorrect, you need to file a dispute with each credit agency. Visit the sites listed above for more information on filing disputes.

One last thing, there are numerous companies, and even the credit agencies, that advertise credit monitoring services for a monthly fee. Don't bother. Remember, you're going to live debt free. The chances of becoming a victim of identity theft are smaller when you pay cash than it is when you pay with a wad of credit cards. Check your credit report once a year and you should be just fine.

LIFE AFTER DEBT

Life after debt means one thing: liberation. You are now free from the shackles of debt. You no longer have to write all those checks each month to your creditors. You may walk to your mailbox and discover that it's empty! No more credit card bills! No more car payments; maybe even no more mortgage payments!

You'll notice that you'll have more disposable income. All that money used to service debt is now available to service you! You can save it, invest it, pay for your kids' college fund, and help out your family or whatever you can think of.

What about buying big ticket items without debt, like a car, home improvements, or a major appliance? Well, like people used to do in the days before debt became chic, they saved their money and paid cash. If you're in the market for a car, you may have to end up with a good used car rather than a shiny new one. Better yet, repair your current car and keep it running. It's almost always cheaper to repair your current car than it is to buy a new one.

When it comes to buying appliances and other large-ticket items, you don't need to buy the biggest and most expensive. That was easy to do with credit. The low monthly payments and deferred interest made it seem

affordable. Not any longer. Purchase the model one or two steps below for bigger savings.

What about buying a house? In today's market, it's almost impossible to buy a house with taking out a mortgage. The cost of housing is simply too high in most parts of the country. Living without debt means you can save up a much larger down payment, thereby reducing your mortgage payments. Or you can continue to stay in your current home. Finally, there's always the option of renting, which is my preferred method of living. Renting affords me the freedom to move whenever necessary, while living in a comfortable home or apartment; and I'm never saddled with a six-figure mortgage for the next 15-30 years.

The temptation to use credit again once your debt free can be huge. Don't fall back in. Too many people, either through bankruptcy or paying off their debts, get back into the debt trap again and again. They haven't changed their mindset from debt to cash. Hopefully, with the help of this booklet, you have changed to a cash mindset. Once you have, you'll never go back to debt again. You can watch other people who are up to the ears in debt go out and buy a big-screen TV or a new car. You can assure yourself that you've been there before and never wish to go back. Your friends may complain about their debt levels and where all the money is going. You can confidently tell them you have no debt and love living

debt free. They may be shocked to hear from someone who actually doesn’t have any debt. Then they may ask you how you did it? Simply give them a copy of this free booklet.

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